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No. 96-1570

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

NYNEX CORPORATION, NYNEX MATERIEL ENTERPRISE COMPANY, and NEW YORK TELEPHONE COMPANY,
Petitioners,

v.

DISCON INCORPORATED,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF OF THE CONSUMER ELECTRONICS MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

Amicus curiae, the Consumer Electronics Manufacturers Association ("CEMA"), pursuant to Supreme Court Rule 37, respectfully moves for leave to file a brief in support of the Petitioners in this matter. Petitioners have provided written consent to CEMA's participation as *amici curiae*. Respondent's have not. *See* Exhibit A.

INTEREST OF AMICUS

The Consumer Electronics Manufacturers Association is a not-for-profit trade association that represents over 300 manufacturers of audio, video and home information equipment. Approximately $66 billion of consumer elec-

tronics products were sold at retail in the United States last year. The decision by the Second Circuit below is of great concern to the members of CEMA because it ignores the settled law of this Court and casts a destructive cloud of antitrust uncertainty upon the highly efficient and pro-competitive business models which individual CEMA members have used to distribute their products to consumers in the United States.

With hundreds of brands being sold of various consumer electronics products, such as televisions, CD players, loudspeakers, computers, and videocassette recorders, the consumer electronics industry has been among the most competitive in the United States. One important aspect of this competition has been the ability of individual manufacturers to select the distributors and retailers with whom they deal in order to maximize and pass along efficiencies, prevent "free riding", and enhance inter-brand competition. The decision below threatens the continuation of these pro-competitive distribution arrangements, which benefit consumers, by raising the possibility that they might be characterized as *per se* unlawful "two-firm group boycotts" subject to treble damage liability.

Because this Court's determination as to whether to grant the Petition will have a critical impact on the ability of consumer electronics companies to continue their pro-competitive business models without facing crippling antitrust risks, it is of substantial interest to *amicus curiae*. Moreover, *amicus curiae* can provide the Court with relevant information about the consumer electronics industry that will assist the Court in assessing the impact of the decision below on pro-competitive distribution arrangements currently being used in the United States.*

* CEMA has previously appeared as *amicus curiae* before this Court in connection with similar antitrust issues having important ramifications for the consumer electronics industry. *See, e.g.* Brief of the Consumer Electronics Manufacturers Association As Amicus Curiae In Support of Affirmance, *Business Elec. Corp.* v. *Sharp Elec. Corp.*, No. 85-1910 (filed Nov. 6, 1987).

CONCLUSION

For the foregoing reasons, CEMA respectfully submits that it has the necessary interest in this matter to participate as *amicus curiae*, and that its filing of a brief will be desirable and useful for the Court. A copy of this brief is submitted with this motion.

Respectfully submitted,

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BRIEF OF THE CONSUMER ELECTRONICS MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

The Consumer Electronics Manufacturers Association ("CEMA"), a not-for-profit trade association that represents over 300 manufacturers of audio, video and home information equipment, files this *amicus curiae* brief in support of Petitioners.[1] Approximately $66 billion of consumer electronics products were sold at retail in the United States last year. The decision by the Second Circuit below

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[1] Pursuant to Rule 37.2(a) of this Court, consent to the filing of this brief has been granted by Petitioners but denied by Respondents. Petitioners' consent has been filed with the Clerk of the Court.

is of great concern to the members of CEMA because it ignores the settled law of this Court and casts a destructive cloud of antitrust uncertainty upon the highly efficient and pro-competitive business models which individual CEMA members have used to distribute their products to consumers in the United States.

With hundreds of brands being sold of various consumer electronics products, such as televisions, CD players, loudspeakers, computers, and videocassette recorders, the consumer electronics industry has been among the most competitive in the United States. One important aspect of this competition has been the ability of individual manufacturers to select the distributors and retailers with whom they deal in order to maximize and pass along efficiencies, prevent "free riding", and enhance interbrand competition.[2] The decision below threatens the continuation of these pro-competitive distribution arrangements, which benefit consumers, by raising the possibility that they might be characterized as *per se* unlawful "two-firm group boycotts" subject to treble damage liability. Because this Court's determination as to whether to grant the Petition will have a critical impact on the ability of consumer electronics companies and other manufacturers to continue their pro-competitive business models without facing crippling antitrust risks, it is of substantial interest to *amicus curiae*.[3]

SUMMARY OF ARGUMENT

By resurrecting the possibility of applying a *per se* rule of illegality to vertical non-price distribution agreements,

[2] The terms "distributor(s)" and "retailer(s)" are used interchangeably throughout this brief, as some consumer electronic manufacturers use a two-step distribution process—going through distributors to retail dealers—while others sell directly to retail dealers.

[3] This *amicus curiae* brief represents the consensus view of the diverse membership of CEMA. It should not be construed as having been submitted on behalf of or representing the views of any individual company.

the decision below is in direct conflict with prior decisions of this Court and the decisions of other Circuit Courts of Appeals. Moreover, by significantly increasing the uncertainty of treble damage liability in the previously settled law of vertical restraints, the Court of Appeals' decision places in jeopardy, and will significantly increase the costs of, efficient distribution arrangements and pro-competitive business models which would otherwise pass through to consumers the benefits of competition in the form of lower prices, greater services and enhanced product availability.

Twenty years ago, this Court revolutionized antitrust law by recognizing the pro-competitive benefits of vertical non-price restraints and holding them subject to the rule of reason, as opposed to the *per se* rule. *Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57-59 (1977). Twelve years ago, this Court made it clear that the *per se* rule against even horizontal group boycotts should not apply where there was a reasonable possibility of an efficiency justification. *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293-298 (1985). Nine years ago, this Court completed the circle by holding that, in the absence of an agreement to fix specific prices or price levels, the rule of reason applied to all vertical agreements, even when they had horizontal effects on price competition. *Business Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717, 735 (1988). The combined effect of these decisions has been to permit the full realization of efficiency-enhancing vertical supply and distribution arrangements, which have greatly benefited consumers. The decision below threatens these benefits, and directly conflicts with the fundamental teachings of *GTE Sylvania*, *Northwest Stationers* and *Sharp*, by resurrecting the possibility that the *per se* rule against group boycotts may be applied to vertical agreements by a single manufacturer to do business with only particular suppliers or distributors.

The consumer electronics industry has been a leader in developing pro-competitive business models for vertical

distribution structures that have provided enormous benefits to consumers. Indeed, these models have made the distribution of consumer electronics products in the United States the most efficient and competitive in the world. The decision below threatens these pro-competitive distribution arrangements by exposing the manufacturers who develop such arrangements to the uncertainty and threat of *per se* treble damage liability.

As this Court has recognized, for many products, competition is most effective when retailers offer prospective purchasers a high level of pre-sale and post-sale services, educating the customer about the product, demonstrating its capabilities, and exploring with the customer whether the product meets his or her needs. These services are particularly important for products which are new to the market and unfamiliar to consumers, and, in general, for any complex product where consumer demand depends on understanding the product and receiving a high level of pre and post-sale service. The provision of such services maximizes inter-brand competition, increases sales, and enhances consumer satisfaction.

A manufacturer which has researched a market, identified a demand, and developed a product to meet that demand thus has a critical interest in structuring the distribution network through which its product will be sold. To ensure the efficient marketing of its products, a manufacturer must be able to exercise a reasonable degree of control over its distribution network, including the ability to select with whom it will deal. In particular, to create a distribution system in which dealers offer the most effective mix of services, a manufacturer must be able to limit the number of its dealers and enter into such other vertical non-price agreements as may be necessary to realize efficiencies and/or enhance inter-brand competition.

This Court should grant the Petition to prevent the decision below from chilling a manufacturer's ability to

create and maintain efficient distribution and supply networks by permitting artful antitrust pleading against such distribution arrangements to raise a new and unwarranted threat of *per se* treble damage liability. Hundreds of billions of dollars of commerce could be adversely affected if the decision below is permitted to inject new antitrust risks and uncertainty into the previously settled law of vertical non-price restraints.

ARGUMENT

I. THE DECISION BELOW IS IN CONFLICT WITH THE PRIOR RULINGS OF THIS COURT AND CREATES A SPLIT OF AUTHORITY AMONGST THE CIRCUIT COURTS OF APPEALS.

Beginning with the landmark decision in *GTE Sylvania* and extending through the more recent ruling in *Sharp*, this Court has revolutionized antitrust law in the area of vertical non-price restraints by holding that the substantial potential of these arrangements to provide pro-competitive benefits requires application of the fiexible rule of reason, rather than any *per se* rule. *See, e.g., Sharp Elec. Corp.*, 485 U.S. 717 (1988); *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752 (1984); *GTE Sylvania, Inc.*, 433 U.S. 36 (1977). The results have been of enormous benefit to consumers and manufacturers alike—with the United States developing the most efficient and competitive distribution networks in the world.

Despite the above, the Second Circuit has now injected new uncertainty and risks of treble damage liability into the previously settled law of vertical non-price restraints by holding that a *per se* rule of illegality might be applied to certain vertical distribution or supply agreements if they can be characterized as a "two-firm group boycott." Petition ("Pet.") at 11a-13a. This ruling conflicts with the prior decisions of this Court, and other circuits, in at least three important respects.

First, the decision below conflicts with the basic rule of *GTE Sylvania* and *Sharp* that vertical non-price restraints should always be judged under the rule of reason because of their potential for pro-competitive, efficiency-enhancing benefits:

> In [*GTE Sylvania*] we refused to extend per se illegality to vertical nonprice restraints specifically to a manufacturer's termination of one dealer pursuant to an exclusive territory agreement with another. . . . We concluded that vertical nonprice restraints had not been shown to have such a "pernicious effect on competition" and to be so "lacking in redeeming value" as to justify per se illegality. Rather, we found that they had real potential to stimulate interbrand competition, "the primary concern of antitrust law."

Sharp, 485 U.S. at 724 (citing to *GTE Sylvania, supra* at 58-59). Moreover, as these decisions point out, a *per se* rule is unwarranted because there is no economic support for the claim that non-price vertical restraints have any cartel-facilitating effect:

> [The] opinion in *GTE Sylvania* noted a significant distinction between vertical nonprice and vertical price restraints. That is, there was support for the proposition that vertical price restraints reduce interbrand price competition because they facilitate cartelizing. . . . Similar support for the cartel-facilitating effect of vertical nonprice restraints was and remains lacking.

Sharp, supra, 485 U.S. at 725 (citations and internal quotations omitted).

There is thus no basis for the Second Circuit's holding that a *per se rule* of illegality could be applicable to an agreement by a manufacturer to use only one supplier or distributor merely because the face of the complaint alleges an anti-competitive intent and effect and does not

disclose any procompetitive rationale. *Petition* at 12a. If not reversed, disgruntled dealers and suppliers around the country can be expected to make similar allegations in order to threaten manufacturers who do not wish to deal with them with the possibility of *per se* treble damage liability.

Second, the decision below disregarded the controlling authority of *Sharp* when it relied upon pre-*Sharp* precedent for the proposition that "an agreement between two firms . . ., even in a vertical relationship, may be characterized as a horizontal restraint of trade if the agreement seeks to disadvantage the direct competitor . . . of one of the conspiring firms." *Pet.* at 10a-11a (citations omitted). This "horizontal effects" rationale for applying a *per se* rule to a vertical non-price agreement was expressly advocated by the dissent, but rejected by the majority opinion, in *Sharp*:

> The dissent apparently believes that whether a restraint is horizontal depends upon whether its anticompetitive effects are horizontal, and not upon whether it is the product of a horizontal agreement. That is of course a conceivable way of talking, but if it were the language of antitrust analysis there would be no such thing as an unlawful vertical restraint, since all anticompetitive effects are by definition horizontal effects.

485 U.S. 717, 730. By adopting the rejected views of the *Sharp* dissent, the decision below is in direct conflict with the holdings of this Court.

Third, the decision below conflicts with this Court's prior decisions as well as the decisions of nine other Courts of Appeal, in holding that the *per se* rule of *Klor's Inc.* v. *Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959), can be applied to so-called "two-firm group boycotts." As the Second Circuit first noted, but then disregarded, *Klors* involved a situation in which several

competing manufacturers conspired with a retailer not to deal with a particular customer (*i.e.*, it was a *horizontal agreement*). *Pet.* at 11a. It did not concern a purely vertical agreement with one supplier or distributor not to deal with others, such as was at issue below. Extending the *per se* rule against group boycotts to such vertical non-price agreements is contrary to this Court's decision in *Northwest Wholesale Stationers*, which made it clear that the *per se rule* against group boycotts should be limited to only those horizontal boycotts by firms with market power that lack any plausible efficiency justification. *Northwest Wholesale Stationers*, 472 U.S. at 293-98. It is also contrary to this Court's decision in *Sharp*, which applied the rule of reason, not the *per se* rule, to an alleged agreement with one customer to terminate another. *Sharp*, 485 U.S. at 735. Finally, it is contrary to the decision of at least nine other circuits, which have refused to extend the *per se* rule of *Klors* to purely vertical agreements in the guise of "two-firm group boycotts."[4]

In sum, the Second Circuit's decision is in direct conflict with the decision of this Court as well as other Courts of Appeal. Unless the Petition is granted to correct this fundamental error, the settled antitrust environ-

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[4] *See, e.g., Bailey's Inc.* v. *Windsor America, Inc.*, 948 F.2d 1018, 1031 (6th Cir. 1991); *Lomar Wholesale Grocery, Inc.* v. *Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 590-91 (8th Cir. 1987); *Westman Commission Co.* v. *Hobart Int'l, Inc.*, 796 F.2d 1216, 1224 n.1 (10th Cir. 1986), *cert. denied*, 486 U.S. 1005 (1988); *Terry's Floor Fashions, Inc.* v. *Burlington Indus., Inc.*, 763 F.2d 604, 610 n.10 (4th Cir. 1985); *Construction Aggregate Transp., Inc.* v. *Florida Rock Indus., Inc.*, 710 F.2d 752, 775 n.42 (11th Cir. 1983); *Products Liab. Ins. Agency, Inc.* v. *Crum & Forster Ins. Cos.*, 682 F.2d 660, 664-65 (7th Cir. 1982); *Gough* v. *Rossmoor Corp.*, 585 F.2d 381, 387 (9th Cir. 1978); *E.A. McQuade Tours, Inc.* v. *Consolidated Air Tour Manual Comm.*, 467 F.2d 178, 186 (5th Cir. 1972), *cert. denied*, 409 U.S. 1109 (1973); *Ark Dental Supply Co.* v. *Cavitron Corp.*, 461 F.2d 1093, 1094 (3d Cir. 1972).

ment in which pro-competitive vertical distribution and supply decisions have been made will be severely undermined.

II. THE PETITION SHOULD BE GRANTED TO PREVENT THE SECOND CIRCUIT'S DECISION FROM HAVING SERIOUS ADVERSE CONSEQUENCES FOR CONSUMERS AND BUSINESSES.

If not overturned, the Court of Appeals' decision will have serious adverse effects on consumers and businesses throughout the country. It will significantly raise the risk of treble damage liability and inject new uncertainty into the law of vertical non-profit restraints—chilling the many efficient distribution arrangements which the members of CEMA and other manufacturers have carefully developed over the last two decades to bring to consumers the benefits of competition. Indeed, because manufacturers who distribute their products on a nationwide basis can generally be subject to suit in many parts of the country, a departure from this Court's law of vertical restraints in just a single Circuit Court of Appeals can significantly threaten a company's pro-competitive distribution agreements.

The consumer electronics industry in which the members of CEMA participate presents a classic example of the type of efficient distribution arrangements that will be placed in jeopardy if the decision below is not reversed. Over the past ten years, there have been few industries more competitive than the consumer electronics industry. This is evident from not only the rapid pace of technical innovation and new product introduction in these businesses, but also from the remarkable achievement of price deflation of three percent or more annually, across the entire marketplace of consumer electronics goods:

Goods	1986 Average Dealer Price (Dollars)	1996 Average Dealer Price (Dollars)	Total / Annual Percent Change
CD Player	207	157	−24 / −3
Stereo Tape Deck	159	114	−28 / −3
Home Speakers	98	66	−33 / −4
Boombox	40	30	−25 / −3
Car CD Player	489	199	−59 / −9
VCR	296	200	−32 / −4
Camcorder	1,029	565	−45 / −6
25" Color TV	404	255	−37 / −4

These benefits of vigorous competition have been passed onto consumers through the efficient distribution arrangements which members of CEMA have been able to enter into under the flexible rule of reason that is applied to vertical non-price restraints. The Court of Appeal's decision deals a serious blow to these pro-competitive business models by creating the risk and uncertainty that a *per se* rule of illegality might be applied to purely vertical agreements by a manufacturer to do business with only a limited number of suppliers or dealers.

Most manufacturers of consumer electronics products rely on specific types of retailers to bring their products to consumers. The specific type of distribution arrangement that will maximize efficiencies varies from product to product. A manufacturer who has studied a market, identified a demand, and developed a product to satisfy that particular demand, is in the best position to know what sort of vertical distribution arrangements will maximize the competitiveness of its products in the marketplace. To carry out these pro-competitive decisions, an ability to enter into vertical agreements without the draconian risk of possible *per se* antitrust liability is essential.

For many consumer electronics products, effective marketing requires that retailers provide consumers with a high level of pre- and post-sale services. A manufacturer that has developed a new type of product may require retailers to provide potential customers with information

about the product's function and capabilities, in order to educate consumers. Or, a manufacturer that believes its product has significant advantages over the products of its competitors may require the retailer to incur the expense necessary to train a staff which can explain and demonstrate those advantages. A manufacturer may also wish to ensure that retailers carry a broad line of products, maintain sufficient stock to be able to meet orders quickly, provide an attractive and spacious shopping environment, offer prompt delivery and installation, or maintain facilities to repair products the retailer has sold. As this Court recognized in *GTE Sylvania*:

> The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product. Because of market imperfections such as the so-called "free-rider" effect, these services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did.

GTE Sylvania, 433 U.S. at 55.

One example of an entire product category where consumers have benefitted from exclusive distribution relationships is "high-end" audio products. These are higher priced, high quality loudspeakers, amplifiers and stereo components manufactured by over 100 U.S. companies and recognized worldwide as being superior to mass-market audio products. Most high-end companies, such as Martin-Logan, Thiel, Conrad-Johnson and Meridian, rely on only one dealer per marketplace. They invest in and train this dealer to provide the pre- and post-sale services which consumers require. This U.S. distribution model is played out worldwide where high-end audio companies maintain exclusive distribution arrangements with international distributors in other countries. It is this type of procompetitive vertical distribution model, which has allowed the U.S. high-end audio industry to

prosper and produce some one billion in U.S. exports, that is being threatened with the possibility of *per se* antitrust liability by the decision below.

In order to maintain such pro-competitive distribution arrangements, it is critical that manufacturers, like the members of CEMA, retain the freedom to enter into vertical non-price agreements, and limit those dealers with whom they will do business, without facing rampant antitrust uncertainty and the risk of *per se* treble damage liability. The decision below destroys the reasonable and certain antitrust environment which this Court has fostered to make possible the development and maintenance of pro-competitive vertical non-price restraints. Certiorari should be granted to reverse this fundamental error, which endangers pro-competitive distribution arrangements in the consumer electronics and other industries.

CONCLUSION

For the reasons set forth above, *amicus curiae* respectfully urges that a writ of certiorari should issue to review the judgment of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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